



Michael C. Schlachter, CFA
Managing Director & Principal

May 24, 2011

Dr. George Diehr
Chair, Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Revision of Real Assets Policies

Dear Dr. Diehr:

You requested Wilshire's opinion with respect to the proposed revisions to the Real Assets policy.

Recommendation

Wilshire believes that the sections of the policy to which the Investment Committee objected in May 2011 have been removed. Staff is no longer requesting permission to exceed the policy parameters as necessary to restructure the portfolio.

Instead, Staff has expanded the ranges of the policy parameters for the near term, with a gradual step down to the original and desired parameters within four years. In our comments below, we agree with the expansion of Staff's quarterly reports to assist the Investment Committee in monitoring this portfolio. We also offer an alternate approach to allowing Staff the flexibility to manage this portfolio in line with the current policy.

Discussion

Staff has deleted the section of the proposed policy that requested the authority for Staff to exceed the policy as needed to restructure the portfolio. Instead, Staff has proposed some interim guidelines that the Investment Committee can review, approve, and modify if needed until the interim guidelines expire in four years. We believe in concept that this is a reasonable solution to deal with the dual needs of the Investment Committee to impose controls over internally managed portfolios and Staff to execute transactions and conduct activities that will enable Staff to improve the portfolio over time.



However, we do note that the interim policy parameter ranges are rather wide relative to the eventual goal. This has effectively the same result as the original request to allow Staff the discretion to violate the parameters, since a very wide range is not much of a limiting factor in decision making.

We agree with the proposal by Staff that their quarterly progress reports on the status of the Real Estate portfolio should contain comparisons to BOTH the interim and final ranges. This should allow Staff the flexibility to manage the portfolio as is necessary in the short term but will also provide a mechanism to the Investment Committee for monitoring overall progress toward satisfying the ultimate policy parameters.

Alternatively, Staff and the Investment Committee could adopt the suggestion that we made at the May Investment Committee meeting – namely that we can keep the ranges unchanged and accept policy parameter violations as a given in the current state of the portfolio. The Investment Committee could then allow Staff the latitude to engage freely in transactions which improve the status of the portfolio relative to parameters even if a parameter violation continues. However, Staff would be prohibited from engaging in transactions which worsen a violation without Investment Committee approval. This solution would eliminate the need for interim ranges and would prevent current or future Staff from worsening the state of the policy violations without oversight.

Please let us know if you have any questions or comments.

Best regards,

A handwritten signature in black ink, appearing to read 'Michael Smith', with a long horizontal flourish extending to the right.